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Accounting for Bonus Issue

Learning Objectives

After studying this chapter, you will be able to:

- ◆ Understand the provisions relating to issue of bonus shares.
- ◆ Account for bonus shares.

1. Introduction

“Capitalisation of profits refers to the process of converting profits or reserves into paid up capital.” A company may capitalise its profits or reserves which otherwise are available for distribution as dividends among the members by issuing fully paid bonus shares to the members.

A bonus share may be defined as a free share of stock given to current shareholders in a company, based upon the number of shares that the shareholder already owns. While the issue of bonus shares increases the total number of shares issued and owned, it does not increase the net worth of the company. Although the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant. An issue of bonus shares is referred to as a bonus issue. Depending upon the constitutional documents of the company, only certain classes of shares may be entitled to bonus issues, or may be entitled to bonus issues in preference to other classes. No new funds are raised with a bonus issue. A bonus issue (or scrip issue) is a stock split in which a company issues new shares without charge in order to bring its issued capital in line with its employed capital (the increased capital available to the company after profits). This usually happens after a company has made profits, thus increasing its employed capital.

If the subscribed and paid up capital exceeds the authorised share capital as a result of bonus issue, a resolution shall be passed by the company at its general body meeting for increasing the authorised capital. A return of bonus issue along with a copy of resolution authorising the issue of bonus shares is also required to be filed with the Registrar of Companies.

2. Provisions of the Companies Act, 2013

Section 63 of the Companies Act, 2013 deals with the issue of bonus shares. According to Sub-section (1) of this section, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

- (i) its free reserves*;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account:

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

As per Sections 52 (2) and 55 (4) of the Companies Act, the securities premium account and capital redemption reserve account may be applied by the company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. Sub-section (2) of Section 63 provides that no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless—

- (a) it is authorised by its articles;
- (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- (f) it complies with such conditions as may be prescribed.

Sub-section (3) of the Section also provides that the bonus shares shall not be issued in lieu of dividend.

As per Para 39 (i) of Table F given under Schedule I to the Companies Act, 2013, a company in general meeting may, upon the recommendation of the Board, resolve—

** As per Section 2(43) of the Companies Act, 2013, "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. Provided that—*

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or*
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.*

4.3 Accounting

(i) (a) that it is desirable to capitalise any part of the amount for the time being standing to the credit of any of the company's reserve accounts, or to the credit of the profit and loss account, or otherwise available for distribution; and (b) that such sum be accordingly set free for distribution in the specified manner amongst the members who would have been entitled thereto, if distributed by way of dividend and in the same proportions.

(ii) The sum aforesaid shall not be paid in cash but shall be applied, subject to the provision contained in clause (iii), either in or towards— (a) paying up any amounts for the time being unpaid on any shares held by such members respectively; (b) paying up in full, unissued shares of the company to be allotted and distributed, credited as fully paid-up, to and amongst such members in the proportions aforesaid;

3. SEBI Regulations

A listed company or a company which intends to get its securities listed is also required to follow the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made there under. Some of the important regulations regarding restrictions and conditions of bonus issue are as follows:

Conditions for Bonus Issue– Reg. 92 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

A listed company may issue bonus shares to its members if:

- (a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.:
Provided that if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;
- (b) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (c) it has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- (d) the partly paid shares, if any outstanding on the date of allotment, are made fully paid up

Restriction on bonus issue – Reg. 93 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

No issuer shall make a bonus issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding [compulsorily] convertible debt instruments [,if any,] in proportion to the convertible part thereof. The equity shares [so] reserved for the holders of fully or partly [compulsorily] convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion [at] which the bonus shares were issued.

Bonus shares only against reserves, etc. if capitalised in cash – Reg. 94 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares. The bonus share shall not be issued in lieu of dividend.

Completion of bonus issue – Reg. 95 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors: Provided that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

Once the decision to make a bonus issue is announced, the issue can not be withdrawn.

4 Journal Entries**(A) (1) Upon the sanction of an issue of bonus shares**

- (a) Debit Capital Redemption Reserve Account
- Debit Securities Premium Account
- Debit Capital Reserve Account (realised in cash only)
- Debit General Reserve Account
- Debit Profit & Loss Account
- (b) Credit Bonus to Shareholders Account.

(2) Upon issue of bonus shares

- (a) Debit Bonus to Shareholders Account
- (b) Credit Share Capital Account.

(B) (1) Upon the sanction of bonus by converting partly paid shares into fully paid shares*

- (a) Debit Capital Reserve Account (realised in cash only)
- Debit General Reserve Account
- Debit Profit & Loss Account

** As per Companies Act, 2013, the securities premium account and capital redemption reserve may be applied by the company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares.*

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(b) Credit Bonus to Shareholders Account

(2) On making the final call due

(a) Debit Share Final Call Account

(b) Credit Share Capital Account.

(3) On adjustment of final call

(a) Debit Bonus to Shareholders Account

(b) Credit Share Final Call Account

Illustration 1

Following items appear in the trial balance of Bharat Ltd. (a listed company) as on 31st March, 2015:

	₹
40,000 Equity shares of ₹ 10 each	4,00,000
Capital Reserve (including 30,000 being profit on sale of machinery)	75,000
Capital Redemption Reserve	25,000
Securities Premium	30,000
General Reserve	1,05,000
Surplus i.e. credit balance of Profit and Loss Account	50,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 4 shares held and for this purpose, it decided that there should be the minimum reduction in free reserves. Pass necessary journal entries.

Solution

Journal Entries in the books of Bharat Ltd.

	Dr.	Cr.
	₹	₹
Capital Reserve A/c	Dr. 30,000	
Capital Redemption Reserve A/c	Dr. 25,000	
Securities Premium A/c	Dr. 30,000	
General Reserve A/c	Dr. 15,000	
To Bonus to Shareholders A/c		1,00,000
(Bonus issue of one share for every four shares held, by utilising various reserves as per Board's resolution dated.....)		
Bonus to Shareholders A/c	Dr. 1,00,000	
To Equity Share Capital A/c		1,00,000
(Capitalisation of profit)		

Note: Capital reserve amounting ₹ 30,000 realised in cash can only be used for bonus issue.

Illustration 2

Following is the extract of the Balance Sheet of Solid Ltd. as at 31st March, 2015:

	₹
Authorised capital :	
10,000 12% Preference shares of ₹ 10 each	1,00,000
1,00,000 Equity shares of ₹ 10 each	<u>10,00,000</u>
	<u>11,00,000</u>
Issued and Subscribed capital:	
8,000 12% Preference shares of ₹ 10 each fully paid	80,000
90,000 Equity shares of ₹ 10 each, ₹ 8 paid up	7,20,000
Reserves and Surplus :	
General reserve	1,60,000
Revaluation reserve	35,000
Securities premium	20,000
Profit and Loss Account	2,05,000
Secured Loan:	
12% Debentures @ ₹ 100 each	5,00,000

On 1st April, 2015 the Company has made final call @ ₹ 2 each on 90,000 equity shares. The call money was received by 20th April, 2015. Thereafter the company decided to capitalise its reserves by way of bonus at the rate of one share for every four shares held. Show necessary entries in the books of the company and prepare the extract of the Balance Sheet immediately after bonus issue assuming that the company has passed necessary resolution at its general body meeting for increasing the authorised capital.

Solution

Solid Ltd. Journal Entries

2015		Dr. ₹	Cr. ₹
April 1	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Final call of ₹ 2 per share on 90,000 equity shares due as per Board's Resolution dated....)	1,80,000	1,80,000
April 20	Bank A/c Dr. To Equity Share Final Call A/c (Final Call money on 90,000 equity shares received)	1,80,000	1,80,000

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	Securities Premium A/c	Dr.	20,000	
	General Reserve A/c	Dr.	1,60,000	
	Profit and Loss A/c	Dr.	45,000	
	To Bonus to Shareholders A/c			2,25,000
	(Bonus issue @ one share for every four shares held by utilising various reserves as per Board's Resolution dated...)			
April 20	Bonus to Shareholders A/c	Dr.	2,25,000	
	To Equity Share Capital A/c			2,25,000
	(Capitalisation of profit)			

Balance Sheet (Extract) as on 30th April, 2015 (after bonus issue)

	Particulars	Notes	Amount (₹)
1	Equity and Liabilities		
	Shareholders' funds		
a	Share capital	1	12,05,000
b	Reserves and Surplus	2	1,95,000
2	Non-current liabilities		
a	Long-term borrowings	3	<u>5,00,000</u>
	Total		<u>19,00,000</u>

Notes to Accounts

1	Share Capital	
	Equity share capital	
	Authorised share capital	
	1,25,000 Equity shares of ₹ 10 each	<u>12,50,000</u>
	Issued, subscribed and fully paid share capital	
	1,12,500 Equity shares of ₹ 10 each, fully paid	
	(Out of above, 22,500 equity shares @ ₹ 10 each were issued by way of bonus) (A)	11,25,000
	Preference share capital	
	Authorised share capital	
	10,000 12% Preference shares of ₹ 10 each	<u>1,00,000</u>
	Issued, subscribed and fully paid share capital	
	8,000 12% Preference shares of ₹ 10 each (B)	<u>80,000</u>
	Total (A + B)	<u>12,05,000</u>
2	Reserves and Surplus	
	Revaluation Reserves	35,000

	Securities Premium	20,000	
	Less: Utilised for bonus issue	<u>(20,000)</u>	Nil
	General reserve	1,60,000	
	Less: Utilised for bonus issue	<u>(1,60,000)</u>	Nil
	Profit & Loss Account	2,05,000	
	Less: Utilised for bonus issue	<u>(45,000)</u>	<u>1,60,000</u>
	Total		<u>1,95,000</u>
3	Long-term borrowings		
	Secured		
	12% Debentures @ ₹ 100 each		5,00,000

SUMMARY

- Bonus Issue means an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increasing the dividend payout.
- Bonus Issue is also known as a "scrip issue" or "capitalization issue".
- Bonus issue has following major effects :
 - ✓ Share capital gets increased according to the bonus issue ratio
 - ✓ Liquidity in the stock increases.
 - ✓ Effective Earnings per share, Book Value and other per share values stand reduced.
 - ✓ Markets take the action usually as a favourable act.
 - ✓ Market price gets adjusted on issue of bonus shares.
 - ✓ Accumulated profits get reduced.
- Bonus shares can be issued from following :
 - ✓ Free Reserves
 - ✓ Securities Premium
 - ✓ Capital Redemption Reserve.